ABOUT MASSACHUSETTS TAXES

The PROPERTY TAX

Research Highlights

from

THE SPECIAL COMMISSION ON TAX REFORM

The SPECIAL COMMISSION ON TAX REFORM
Co-Chairmen

John W. Olver
Senate

Charles F. Flaherty
House of Representatives

59 Temple Place, Rm. 320 Boston, MA 02111 617-727-6343

THE SPECIAL COMMISSION ON TAX REFORM

A SAMPLER
FINDINGS ON THE PROPERTY TAX

MUNICIPAL FINANCE

--Reliance on the property tax in Massachusetts, once high, is now at just about the national average.

--Although property taxes make up a smaller proportion of local revenues, overall municipal spending has not decreased, essentially because local aid to communities has increased. However, in constant dollars, expenditures were virtually the same in FY87 as they were in FY81.

--Explosive property values and the value of new construction have done much to mitigate the effects of Proposition 2 1/2, but increases in valuation and new growth have not been spread evenly across communities.

--About 25 percent of the state's 351 cities and towns assign different tax rates to different classes of property. Of those who do not assign different rates, close to half (142) have 10 percent or more of their tax base in the commercial/industrial category.

--Cities and towns differ dramatically in fiscal health. Those that experience fiscal hardship more often suffer from a lack of fiscal capacity rather than extreme fiscal need. The property tax remains the key factor in a municipality's fiscal capacity; inequalities in capacity become greater with uneven growth in the tax base.

--Massachusetts cities and towns rely on local option taxes much less than the U.S. average. Generally, were these taxes to be instituted on a statewide level, the municipalities that would benefit the most are those that are already the strongest fiscally.

TAX BURDEN

--Property tax payments as a percentage of income for Massachusetts residents have decreased so that the burden in the Commonwealth has gone from second highest in the U.S. in FY77 to 20th in FY86.

--The property tax burden falls much more heavily on some income classes than others. The property tax is by far the largest tax liability for low income residents; property tax payments make up a significantly larger share of the income for lower income residents than they do for those with higher incomes.

--On average, the property tax burden for elderly homeowners is almost twice as high as the average of the non-elders.

TAX RELIEF

--Massachusetts does not provide any property tax relief to its lower income non-elderly residents.

--The rental deduction on the personal income tax benefits the middle and higher income but not lower income households.

--Property tax relief programs for those over 70 years of age are significantly underutilized.

The Legislature created the Special Commission on Tax Reform in 1984 to evaluate state and local tax policies and to weigh the effects of unprecedented shifts in the state's fiscal structure. The Special Commission's task is to examine existing taxes and recommend changes that will enhance their equity and effectiveness while fostering continued economic growth. In a final report and set of legislative options, the Commission will address any imbalances in equity, efficiency, and cost-effectiveness for the Commonwealth and its taxpayers.

The Commission is composed of 25 members: 16 Legislators and 9 Gubernatorial appointees from the public interest and private sectors.

Co-Chairmen

Senator John W. Olver	Representative Charles F. Flaherty
Chairman	Majority Leader
Joint Taxation Committee	House of Representatives

<u>Senate Members</u>

Sen. Royal Bolling
Sen. Paul Doane
Sen. Richard Kraus
Sen. Mary Padula
Sen. Paul Sheehy

<u>House Members</u>

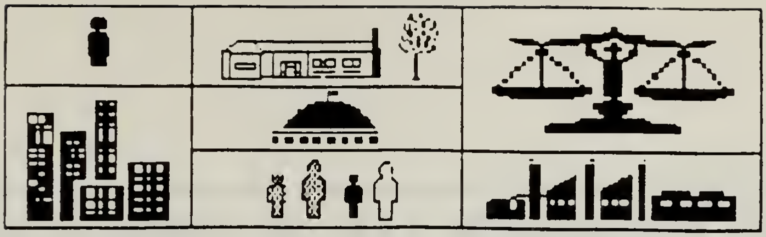
Rep. Carmen Buell
Rep. Robert Durand
Rep. Augusto Grace
Rep. William Glodis
Rep. Robert Havern
Rep. Augusta Hornblower
Rep. Lucile Hicks
Rep. Joseph Mackey
Rep. Richard Moore

<u>Gubernatorial Appointees</u>

Frank Keefe, Secy. of Administration and Finance
Reese Fayde, President, Real Estate Enterprises, Inc.
Nancy Finkelstein, Massachusetts Teachers Association
Richard Manley, President, Massachusetts Taxpayers Foundation
Paul Marshall, Massachusetts Municipal Association
Susan Shaer, League of Women Voters of Massachusetts
Professor Lawrence Susskind, Massachusetts Institute of Technology
J. Coleman Walsh, Esq., Wheeler and West

<u>Commission Staff</u>

Sandra Quinn, Esq., Executive Director
Randy Albelda, Ph.D., Research Director
Helen Pelzman, Communications Director
Kevin Daly, Fiscal Analyst
Yaning Lu, Research Intern
Mona Cosmos, Office Manager



ABOUT MASSACHUSETTS TAXES

This booklet is one of a series summarizing research of the Special Commission on Tax Reform. When complete, the series will include:

Property Taxation
The Sales Tax
Business Taxation
The Personal Income Tax
Measure for Measure: Evaluating Massachusetts Revenue Burdens
Recommendations from the Commission

SOURCES:

The primary sources for the data in this booklet are four Special Commission research reports (see full list of reports at the end of this booklet):

Fourteenth Interim Report of the Special Commission Relative to Property Taxation in Massachusetts (H.5317)

Ninth Interim Report of the Special Commission Relative to Residential Property Tax Burden (H.5149)

The Tenth Interim Report of the Special Commission Relative to Providing a Non-Property Tax Option for Cities and Towns (H.5233)

Seventh Interim Report of the Special Commission Relative to Differences in Budgetary Stress Across Massachusetts Cities and Towns

****

The data in these reports have been updated and supplemented by data from the following sources:

--Advisory Council on Intergovernmental Relations
  Significant Features of Fiscal Federalism, various editions
--House 1, The Governor's Budget Recommendations, various years
--Massachusetts Department of Revenue:
  Bureau of Analysis, Estimation and Research;
  Division of Local Services; Municipal Data Bank
--Massachusetts Taxpayers Foundation
--U.S. Dept. of Commerce (Government Finances, various years, and
  Survey of Current Business)

****

FOR MORE INFORMATION:

The Special Commission on Tax Reform
59 Temple Place, Rm. 320
Boston, Mass. 02111
617-727-6343

THE PROPERTY TAX IN MASSACHUSETTS

Research Findings About:

I. The Property Tax and the Local Fiscal Picture

--Reliance on Property Taxes: Mass. vs. U.S.

--The Municipal Revenue Mix
- Levy and Local Aid
- Local Spending

--After Proposition 2 1/2
- The Levy
- The Property Tax Burden
- Increasing Property Values
- Increasing Levies

--The Classification Amendment

--Assessing Municipal Fiscal Health

--Other Potential Sources of Local Revenues
- Local Non-Property Taxes
- Tax Exempt Property

II. The Property Tax and the Residential Taxpayer

--Residential Property Tax Revenues

--Residential Taxpayers by Income
- Homeowners
- Tenants

--Combined Tax Burden
- Sales, Property, Income

--Property Tax Relief
- Renters' Deduction
- Taxpayers 70 and Over

I. The PROPERTY TAX and the LOCAL FISCAL PICTURE

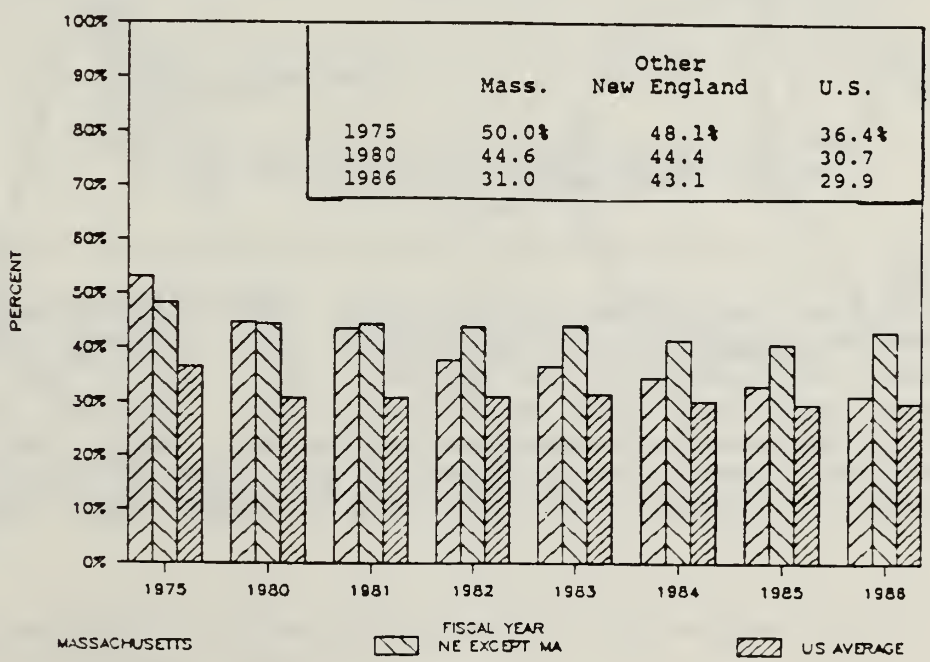
The property tax, at $3.5 billion, is the second largest tax collected by state or local governments in Massachusetts. Until FY86, when it was surpassed by the personal income tax, the property tax was the single largest source of tax revenue in the state.

Historically the property tax has constituted a high proportion of the Commonwealth's total state and local taxes. However, in the last 15 years its share has been declining steadily -- since 1975, the property tax's share of the total has dropped 19 percentage points.

From making up half of all the Commonwealth's state and local taxes in 1970, by 1986 the property tax represented 31 percent of the total taxes collected, well below the average of the other New England states and just 1.1 percentage points above the U.S. average of 29.9 percent.

Increases in sales and personal income tax collections due to the state's healthy economic climate, as well as the limited growth in property tax collections resulting from Proposition 2 1/2, are primarily responsible for this shift in the Commonwealth's revenue mix.

Property tax as percent of state and local own-source taxes
FY80-FY86



	Mass.	Other New England	U.S.
1975	50.0%	48.1%	36.4%
1980	44.6	44.4	30.7
1986	31.0	43.1	29.9

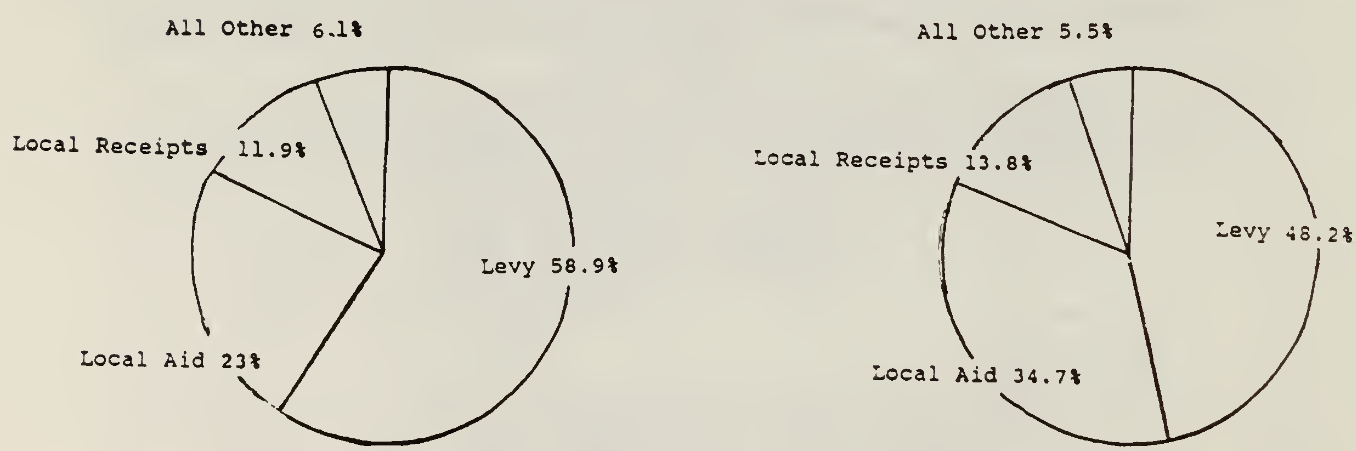
Local Revenue Mix

Although the property tax certainly remains the "mainstay" of municipal finance, the "mix" of municipal revenues -- the shares that come from local or state sources -- has changed considerably in the aftermath of Proposition 2 1/2. (A section explaining Proposition 2 1/2, the state's property tax limit, is included at the end of this booklet.) Decreasing local reliance on the property tax and increasing reliance on the aid the state provides communities are illustrated here and detailed more fully in the sections that follow.

In the year before Proposition 2 1/2 went into effect, 59 percent of local revenues came from the property tax. By FY87, the share had dropped to 48 percent; the difference was made up by increases in local aid and in local receipts from the motor vehicle excise and various fees and fines.

FY81 Municipal Revenues
By Source
Statewide Average

FY87 Municipal Revenues
By Source
Statewide Average

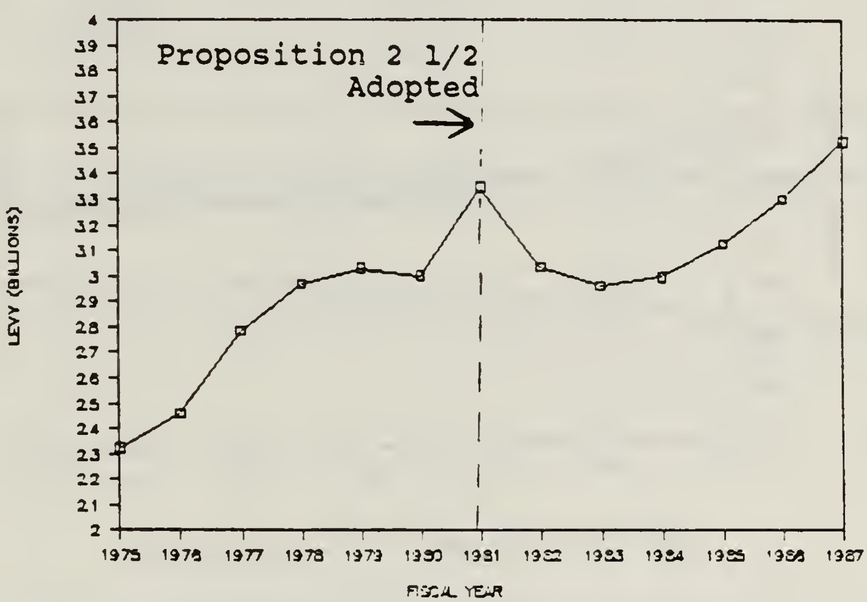


The Levy

After increasing dramatically through most of the late 1960's and early 1970's, property tax revenues dropped sharply in the initial year of Proposition 2 1/2. The levy "bottomed out" in FY83 and began rising again.

In 1975, the levy totalled $2.32 billion. It was $3 billion in 1980 and by 1981, the last fiscal year without the 2 1/2 limits, it had risen to $3.35 billion. After dropping sharply -- over 10 percent -- in the first two years under Proposition 2 1/2, collections from the property tax have been climbing gradually. In FY87, the sixth year of 2 1/2, the pre-2 1/2 high of FY81 was exceeded for the first time.

Total levy: FY75 - FY87



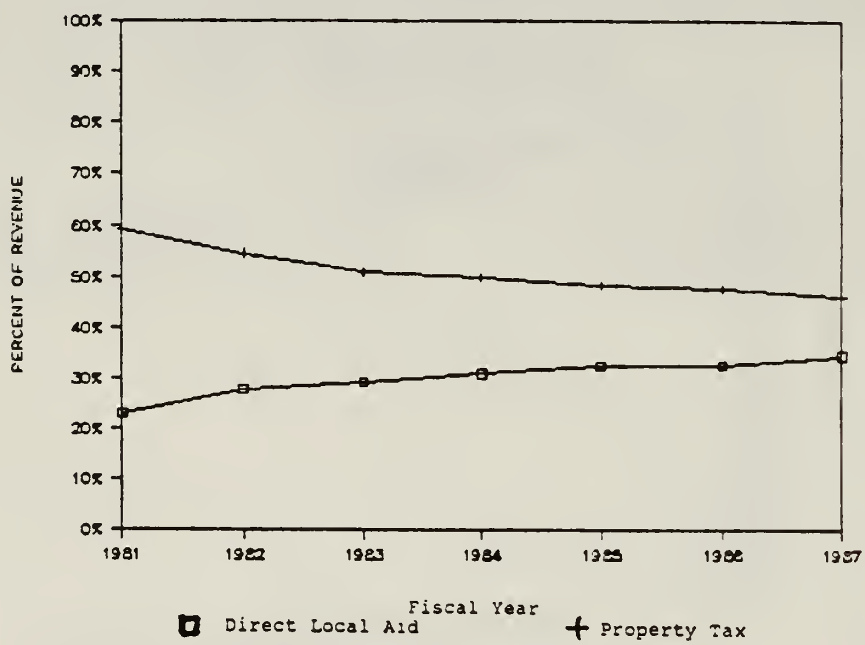
Increases for the levy for the individual communities have not been uniform. To illustrate the differences among the 351 cities and towns, the average levy increase statewide in FY87 was 6.5 percent. For communities with the lower property tax base (the lowest 10 percent in terms of Equalized Valuations), the average increase was 5.4 percent; for those with a wealthier tax base (the upper 10 percent), the average increase was 13.7 percent.

*An explanation of the provisions of Proposition 1/2 is included at the end of this booklet.

The Levy and Local Aid

Since Proposition 2 1/2, which went into full effect in FY82, the declining reliance on the property tax has been accompanied by increasing direct financial support from the state through local aid. The shift in the share of both the property tax and local aid as a portion of all local revenues is illustrated graphically below.

Property tax levy and direct local aid
as a percent of local revenue
FY81-FY87



Since 1980, total local aid, direct and indirect, has doubled, moving from \$1.29 billion in 1980 to \$1.5 billion in the first fiscal year of Proposition 2 1/2 (FY82) and rising to \$2.64 billion for FY87.

"Direct" local aid refers to funds distributed to the cities and towns through various programs, while "indirect" refers to the funds the state spends when it assumes responsibility for a program previously paid for locally.

As the totals for local aid distributed since 1981 given below indicate, local aid has increased consistently since Proposition 2 1/2. In inflation-adjusted dollars, the FY87 amount is 50 percent more than FY81's.

Direct and indirect local aid
Actual, FY81-87, and in constant 1981 dollars

Year	$ in billions	In Constant 1981 Dollars*
1981	$1.31	1.31
1982	1.55	1.45
1983	1.70	1.51
1984	1.87	1.57
1985	2.10	1.69
1986	2.26	1.76
1987	2.64	1.96

*Using the implicit price deflator for purchases of local and state government goods and services.

LOCAL SPENDING

Increases in local aid and, to a lesser degree, additional income from increased municipal fees and charges, explain how it has been possible for total local expenditures to continue to rise despite the decline in municipal property tax levies. It should be noted, however, that when the figures are adjusted for inflation, total municipal expenditures between 1981 and 1987 have fallen slightly.

Total local expenditures
FY81-87

Fiscal Year	$ in Billions	In Constant 1981 Dollars*
1981	$5.68	$5.68
1982	5.57	5.20
1983	5.80	5.17
1984	6.01	5.08
1985	6.45	5.20
1986	6.95	5.40
1987	7.65	5.67

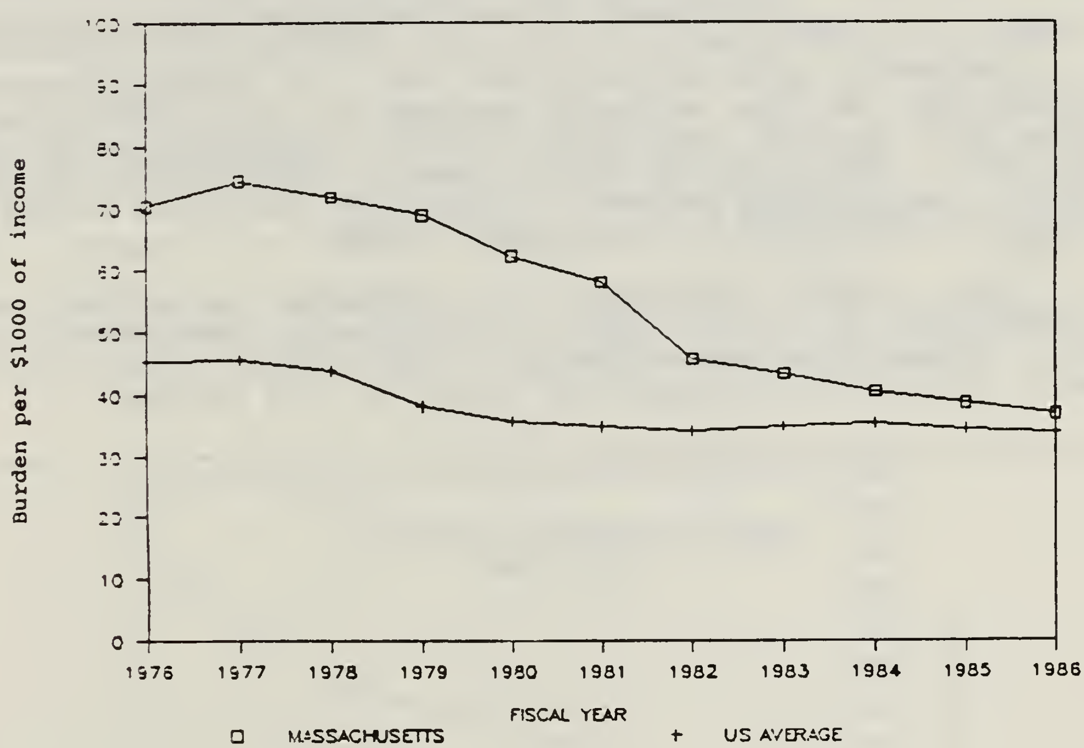
*Using the implicit price deflator for purchases of local and state government goods and services.

The "Property Tax Burden"

Although actual property tax collections have been increasing since FY84, the property tax burden, which measures total property taxes collected in relation to aggregate statewide personal income, has been declining since the late 1970's. In FY86 the property tax burden, according to this measure, came within three dollars per thousand of the U.S. average ($36.80 per thousand for Massachusetts vs. the U.S.'s $33.70).

The Commonwealth's rank as to burden fell from FY77's high of second in the U.S. to 20th in FY86.

Property tax burden per $1,000 statewide personal income
FY76-FY86



The growth in property values has done a great deal to mitigate the effects of Proposition 2 1/2, particularly in the first few years. Municipalities already under a mandate to bring their property assessments to market value had an added incentive to carry out revaluations -- the higher their valuation, the higher their levy base.

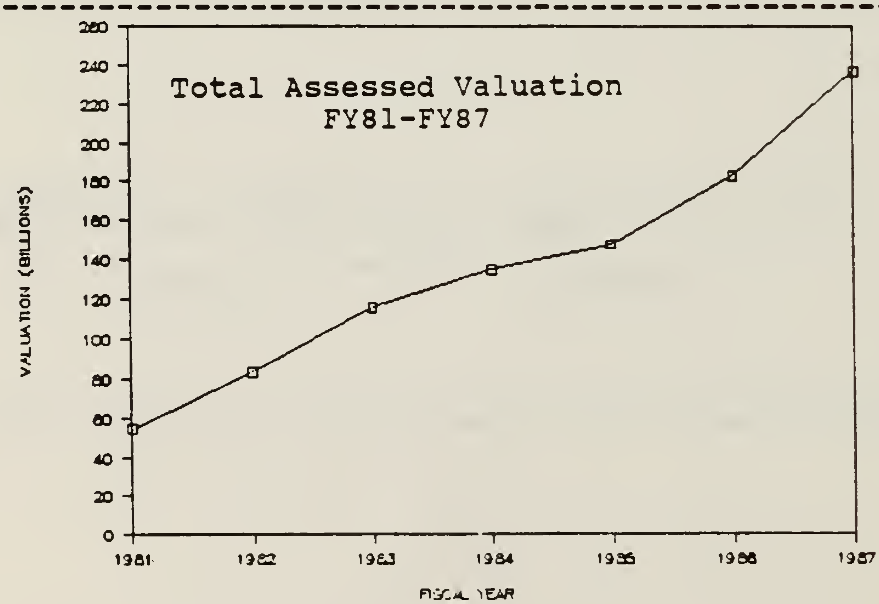
Maintaining market values through the required triennial revaluations gives cities and towns more flexbiility to consider increasing their annual levy limit through an override without fear of exceeding the overall rate limit of $25.00 per thousand.

Communities also benefit -- although quite unevenly -- from being able to use new growth to expand their levy limits during a period of continually escalating values.

Increases in Assessed Valuation

Assessed valuations, that is, the fair value of all properties in the state as assessed by local communities, rose some 300 percent from 1981 to 1987. Just short of $55 billion in 1981, the statewide total jumped to $236 billion in 1987. In fact, the increase between 1986 and 1987 was equal to the entire statewide valuation just six years before.

This rapid increase in assessed valuations softened Proposition 2 1/2's impact considerably, particularly for the many communities who struggled in the earlier years to get or to stay below the 2.5 percent of valuation levy ceiling.



Property values have grown everywhere but not at the same rate in all types of communities. While the increase from FY81 to FY87 was over 500 percent in urbanized centers, it was more typically in the 200 percent range for other types of communities.

Changes in Valuation by Community Type
In billions, FY81-FY87

	FY81	FY87	% Change
Urbanized Center	$12.8	$84.5	560%
Econ. Developed Suburb	16.2	72.6	348
Small Rural Community	1.6	5.8	263
Residential Suburb	6.4	21.6	238
Resort/Retirement Cmmty	4.8	14.8	208
Growth Community	8.6	25.8	200
Rural Economic Center	3.9	11.4	192
TOTAL	$54.3	$236.5	336%

Impact of New Growth

For many communities in need of increased revenues, the addition of new growth allowed since FY83 has become at least as important as the 2.5 percent annual levy increase allowed by Proposition 2 1/2. The total of the additional levy attributable to new growth has often exceeded the amount generated by the 2.5 percent annual levy limit increases.

In FY87, the statewide levy total was $3.6 billion, some $416 million of it -- or 11.5 percent -- attributable to the cumulative effect of adding new growth between FY83 and FY87.

However, just as all communities in the state are not experiencing the same rate of growth in property values, the benefits of increases from new growth are also not spread evenly, but rather are concentrated in the wealthier communities. Over the four year period from FY83 to FY87, while the addition of new growth increased levy limits statewide an average of 11.5 percent, the range among individual communities went from a low of 0.21 percent to a high of 38 percent.

In dollar value, growth has brought no less than $35 million in additional valuation to the communities up to a high of $126 million a year (even before the addition of growth became a requirement in setting a new levy limit).

Total Statewide Levy Increase Attributable to New Growth
FY83 to FY88

Millions

	FY83	FY84	FY85	FY86	FY87	FY88*
TOTAL	$34.7	$49.6	$76.9	$114.2	$126.2	$115.6

*276 of 351 municipalities reporting

Voting to Raise More Property Taxes

The recent increases in total levy also reflect the fact that a good number of communities have voted at a local election to levy beyond their allowable 2.5 percent levy limit.

Between 1982 and mid-FY88, 955 proposed overrides and exclusions have been brought before the voters of 202 of the state's 351 communities; these communities have gone to the polls one or more times to vote on one or more of these options.

As of FY87, the statewide levy total had been increased by $38 million as the result of municipal votes to override Proposition 2 1/2's levy limit.

Once again, there is disparity among the communities that share that additional revenue. A disproportionately high percentage of the override votes have occurred in the "residential suburb or resort/retirement" communities (that tend to be wealthier) while virtually none of the urban or rural economic centers (that tend to be the poorer communities) has approved override proposals.

One of the most controversial questions in municipal finance is whether local override capacity should be taken into consideration in assessing fiscal health and, more specifically, in determining the need for aid from the state. "Override capacity" is the difference between the levy limit and the rate limit.

Adopting Different Tax Rates for Different Classes of Property*

Of the 351 cities and towns, in FY87, 86 municipalities chose to apply different tax rates to different classes of property. Of those that chose not to apply different rates, 42 municipalities had more than 20 percent of their levy coming from business/commercial property; 142 had more than 10 percent of their levy comes from business/commercial property.

In FY87, only seven communities adopted the "residential exemption" provision. Three were cities (including Boston).

---

*More details on the Classification Amendment and the Residential Exemption are provided at the end of this booklet.

Differences in Fiscal Health --and Stress-- Across Cities and Towns

Some speak of "budgetary stress" and others of "fiscal health" or "fiscal disparity." No matter what the phraseology, cities and towns do not have the same service needs nor are they equal in their ability to fund these needs with their own fiscal resources. Thus a property taxpayer would pay more for the same level of services in one community than another, even assuming that the communities operate at the same level of efficiency.

A community's ability to finance its local government and services is dependent on the community's tax and revenue base (i.e. its "fiscal capacity"). A fiscally weak community would be unable to finance its service needs while a fiscally strong community could have identical service needs and sufficient resources to provide for those needs.

Fiscal strength can be measured in many ways, although none is precise. The Special Commission's research shows, regardless of the method used, that great disparity exists among communities and that this disparity is a serious problem.

Other general conclusions can be drawn.

Fiscal Health: Some Conclusions

--Property tax base is a source of significant inequality among the cities and towns. As a result of uneven growth in the property tax base, this inequality is increasing.

--Communities experiencing fiscal hardships more often suffer from a lack of fiscal capacity, rather than from extreme fiscal need.

--Comparisons between the fiscally strongest and the fiscally weak reveal sharp contrasts rather than simple gradations. The strongest tend to be very strong and the weakest, very weak.

--Generally, the weakest fiscally are the urban centers and small rural towns.

--Generally, the stronger fiscally are the retirement/resort communities and the suburbs of Boston.

continued

--Poorer communities have higher "uncontrollable" costs and must raise and spend above average amounts of money to deliver an average range of services.

--One-third of the towns have fiscal resources that are put out of reach by Proposition 2 1/2; without that constraint, they would have the capacity to meet their needs.

--Other communities have unused capacity even within the constraints of Proposition 2 1/2; they tend to either have underlying fiscal strength or a low level of local public services.

Voting to Raise More Property Taxes

The recent increases in total levy also reflect the fact that a good number of communities have voted at a local election to levy beyond their allowable 2.5 percent levy limit.

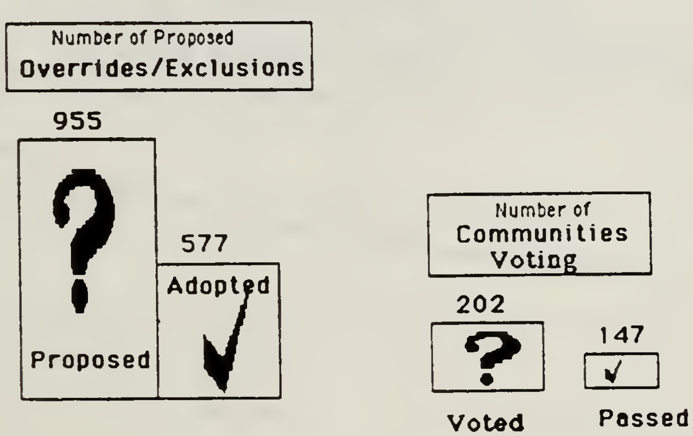
Between 1982 and mid-FY88, 955 proposed overrides and exclusions have been brought before the voters of 202 of the state's 351 communities; these communities have gone to the polls one or more times to vote on one or more of these options.

As of FY87, the statewide levy total had been increased by $38 million as the result of municipal votes to override Proposition 2 1/2's levy limit.

Once again, there is disparity among the communities that share that additional revenue. A disproportionately high percentage of the override votes have occurred in the "residential suburb or resort/retirement" communities (that tend to be wealthier) while virtually none of the urban or rural economic centers (that tend to be the poorer communities) has approved override proposals.

One of the most controversial questions in municipal finance is whether local override capacity should be taken into consideration in assessing fiscal health and, more specifically, in determining the need for aid from the state. "Override capacity" is the difference between the levy limit and the rate limit.

FY82 - FY88*



*Does not include votes taken in FY88 for FY89 budgets

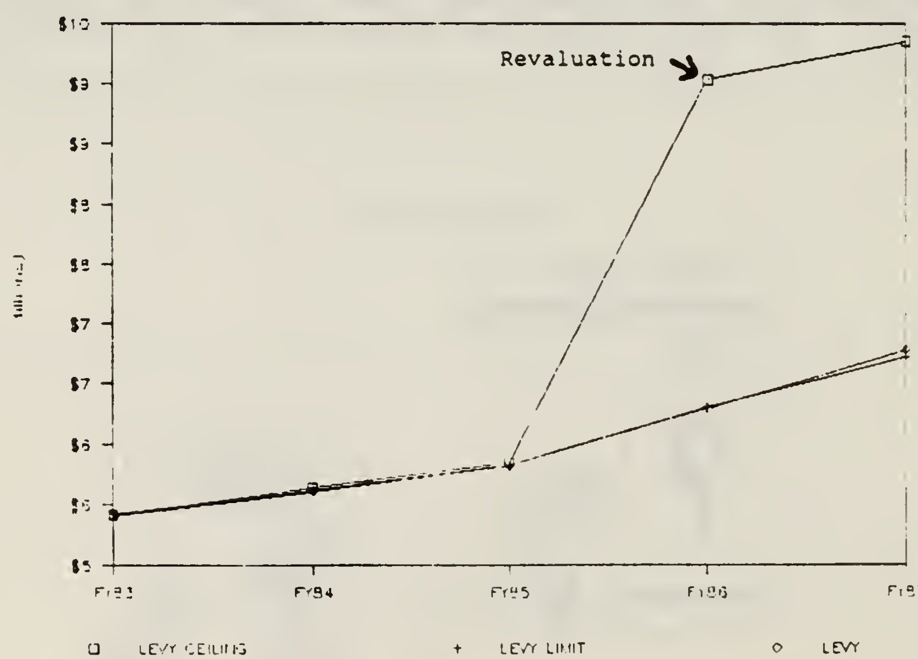
Relationships: Levy Ceiling, Increases, and Limits

The data below are from a town of just over 9,600 people, just south of Boston. They illustrate very well the interplay among the levy ceiling (the amount raised if property were taxed at the Proposition 2 1/2 maximum of 2.5 percent of the assessed valuation), the annual levy limits and increases, and the tax rate. They also illustrate clearly the effect of revaluation on the annual allowable levy increase and on the tax rate.

As the graph indicates, for the first three years shown, the levy, levy limit, and levy ceiling were nearly identical. The FY86 revaluation produced a new ceiling. Otherwise, in that year the ceiling would have prevented the full annual allowable increase to be used; the increased levy would have "bumped" (exceeded) the ceiling of $5.8 million. However, the actual levy still hugs the levy limit.

With the revaluation, the tax rate dropped significantly, as the information on the next page shows.

Sample Town
Relationship of Levy Ceiling, Levy Limit, and Levy
and the Effect of Revaluation



Relationships: Valuation, Tax Rates, and the Levy Figures

The tax rates, assessed valuation, and the data upon which the graphs on the previous pages are based are given below.

For the first three years the tax rates were at $25.00 or pennies less per thousand. However, with the FY86 revaluation, the tax rate dropped significantly.

Sample Town
Relationships: Levy, Tax Rate, and Valuations

	FY83	FY84	FY85	Revaluation FY86	FY87
Levy ceiling	$5,413,000	$5,641,000	$5,847,000	$9,036,000	$9,354,000
Levy limit	5,416,432	5,617,484	5,826,179	6,307,718	6,731,763
Levy	5,411,000	5,607,000*	5,819,000	6,303,000**	6,787,763***
Tax Rate	$25.00	$24.85	$24.88	$17.44	$18.14
Assessed valuation (000's omitted)	$216,556	$225,647	$233,886	$361,432	$374,144

*Increases each year through 2.5% annual allowable increase and a factor for the value of new growth.

**Note that absent revaluation, the town would have not been able to levy an amount as high as this. Its annual allowable increases (as in * above) are limited by the levy ceiling.

***This includes an additional amount levied beyond the limit for a debt exclusion approved by the voters. The levy limit, however, remains the same for purposes of calculating the following year's limit.

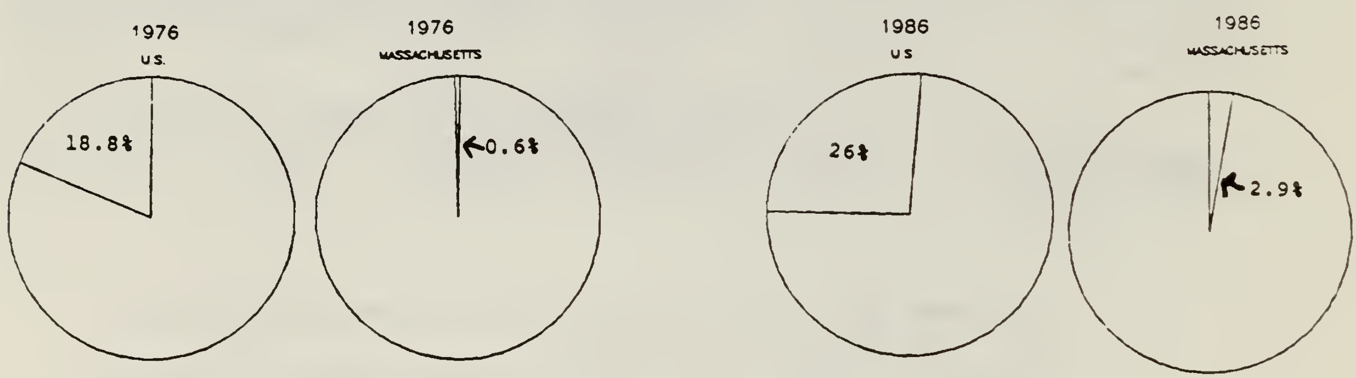
Potential Sources of Local Revenue

The property tax limits of Proposition 2 1/2 have given both state and local officials the impetus to consider other potential income for the cities and towns. Uncertainty about how well state aid to communities can continue to fare in the light of increasing competition for state funds limited by the state tax cap provides yet another reason to examine the potential of other revenue sources.

The municipalities' search for previously untapped revenue sources includes seeking legislative authority to levy a broader range of local taxes (such as a payroll or a sales tax) and negotiating formally or informally with their non-profit institutions for payments in lieu of taxes.

These two areas are covered in the next section.

Non-property taxes as % of local tax revenues

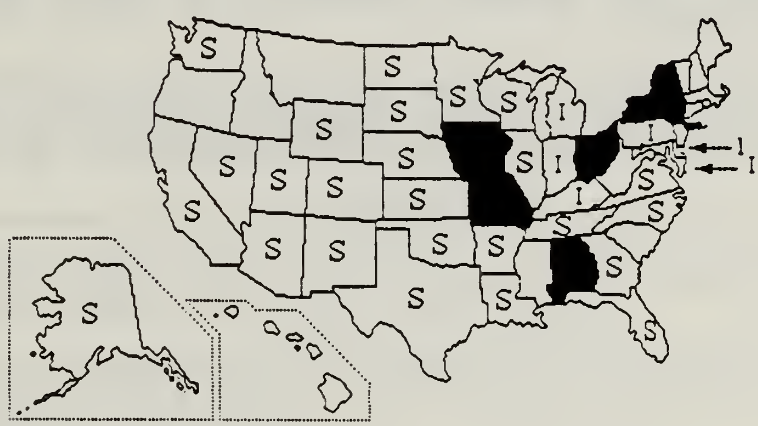


Local Non-Property Tax Options

Historically, the 351 cities and towns of the Commonwealth have relied more heavily than other U.S. communities on the property tax for locally-generated taxes (virtually 100 percent until 1984). The reliance has lessened somewhat since Proposition 2 1/2 as communities have made more use of other tax sources, limited as they may be.

Nationally, in FY88, 29 states authorized a local sales tax and 11 a local income tax. Three-fourths of the country's 49 largest cities have a local sales or income tax that accounted for 58 percent of their tax revenues and 26 percent of their general revenues. By contrast, the Commonwealth's municipal governments still depend on the property tax most heavily.

STATES WITH LOCAL SALES (S) OR INCOME (I) TAXES OR BOTH (■)



Two Existing Local Options

Two local option taxes were authorized for Commonwealth cities and towns in 1985. One makes it possible for cities and towns who elect to levy a local room occupancy tax (in addition to the existing statewide room occupancy tax); the other allows a tax on jet fuel.

In addition, two counties, Dukes and Nantucket, have won the approval of the state Legislature to institute a real estate transfer tax. The use of the proceeds is limited to the purchase of open space.

Room Occupancy and Jet Fuel

Of the 231 cities and towns that are home to establishments that pay the state room occupancy tax, 84 have adopted the local tax (as of mid-FY88). In calendar year 1987 those who voted for the option received some $29 million through this tax. Another $4.2 million would be available for those who have not taken the option; however, those with the greatest benefit to gain have adopted the room occupancy option.

A half dozen cities and towns that have some part of a jetport within their bounds have adopted that local option. Over $13 million was distributed in calendar 1987, nearly all of it to Boston.

Revenue Potential

To explore how much potential revenue other local option taxes might represent to municipalities across the state, the Special Commission developed the data summarized below. The research is based on the assumption that all cities and towns adopt the particular option, taxing at a rate of one percent.

The local option taxes studied were: sales, personal income, payroll, real estate transfer, meals, and room occupancy.

The research indicates clearly that the potential local option tax revenues would be spread even more unevenly across communities than revenues from the property tax or user fees. The distribution varies from tax to tax; a community could realize very high revenues from one tax but much lower revenues from another.

Because these town-to-town variations are so wide, the estimates about which types of communities would benefit do not appear to be encouraging to those who want to find a new, steady source of income for <u>all</u> communities.

Given the individual variations, it's possible to conclude that:

<u>In general:</u>

--Cities and towns that are <u>already fiscally strong</u> would <u>benefit the most</u> from local option taxes.
Such as:
- resort towns on the Cape and in the Berkshires
- Boston suburbs with a high level of commercial or industrial activity.

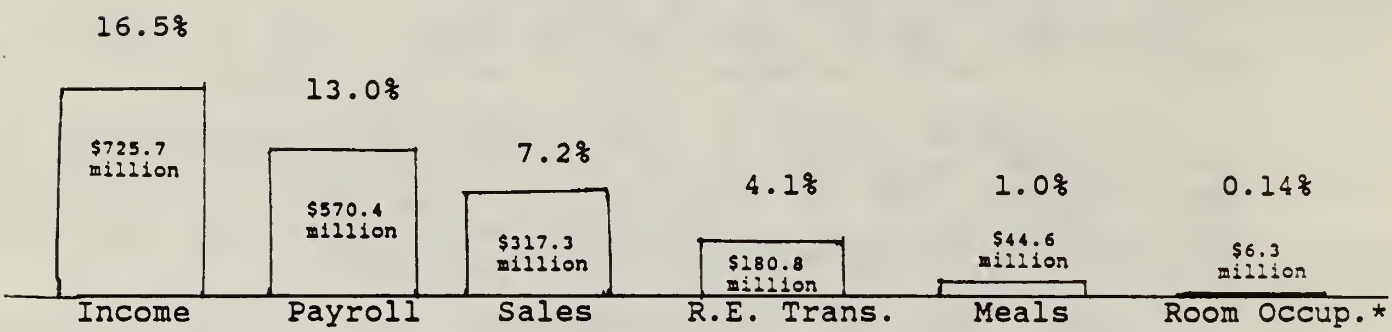
--The communities with the <u>least to gain</u> are those that are <u>suffering most fiscal stress</u>:
Such as:
- small rural communities
- older industrial cities

--Of the individual taxes, the <u>income tax</u> would have the <u>most to offer</u> in total additional tax revenues, especially for communities with 10,000 to 35,000 people.

--<u>Next</u> would be a <u>payroll</u> tax, especially beneficial to the largest cities and communities with a high ratio of employment to population (e.g. those with corporate facilities).

--Municipal treasuries would have the <u>least to gain</u> from the <u>meals and additional room occupancy taxes</u>.

Estimated Dollar and Percent Increase in Total Local Revenues
(Yield based on rate of 1% using actual FY86 statewide revenues)
(Assumes all cities and towns adopt the option)



*84 cities and towns have adopted the tax at rates of 1 to 4%.

Local Option: Pro and Con

While one advantage of local option non-property taxes is that the taxes are generally paid by those who receive the benefits, they present two potential disadvantages. First, there can be "border problems" between neighboring communities when one levies a tax (such as sales) and another does not. Secondly, these taxes, especially the sales, payroll, and income, are more susceptible than the property tax to fluctuations in the economy, making them a less stable source of revenue.

Tax Exempt Property: Looking at Foregone Revenues

Property owned by the state and federal governments and by charitable organizations, such as religious, fraternal, educational institutions, and hospitals are exempt from taxation by state law.

Tax exempt property impacts on communities' local taxation through loss of tax revenues and/or uncompensated cost of public services. However, some communities believe the presence of certain tax exempt property offers certain net benefits, such as increased employment or tourism or the attraction of higher income residents.

The Commission's review reveals:

--severe limitations in the data on the extent and value of these properties, both state-owned and privately-owned; data on tax exempt properties are not available for 19 percent of the communities, including three of the Commonwealth's largest cities; and much of the data that are available are not reliable;

--within the limits of the data, an average of 5.2 percent of property in a community is tax exempt, but the range swings from none to as much as 60 percent;

STATE-OWNED LAND:

--an antiquated state system for reimbursing communities with state-owned land results in an arbitrary distribution of state funds;

--some state authorities do not make payments in lieu of taxes ("PILOT") payments to the communities in which they are located;

--profit-making lessees of state authorities pay no local property taxes.

PRIVATE TAX EXEMPT PROPERTIES:

--private tax-exempt property (primarily health and educational facilities) is more likely to be concentrated in urban centers which tend to be experiencing the most fiscal stress;

--many communities interested in negotiating "in lieu of tax payments" with private tax exempt properties need assistance in valuing property and assessing the costs of providing services to the institution.

II. THE PROPERTY TAX AND THE RESIDENTIAL TAXPAYER

The research about how the property tax burden is distributed.

Data in this section that characterize the property taxpayer base according to income or age or as renters or homeowners are based on a computer model, the Massachusetts Property Taxpayer Simulation Model.

Residential Property Tax Revenues

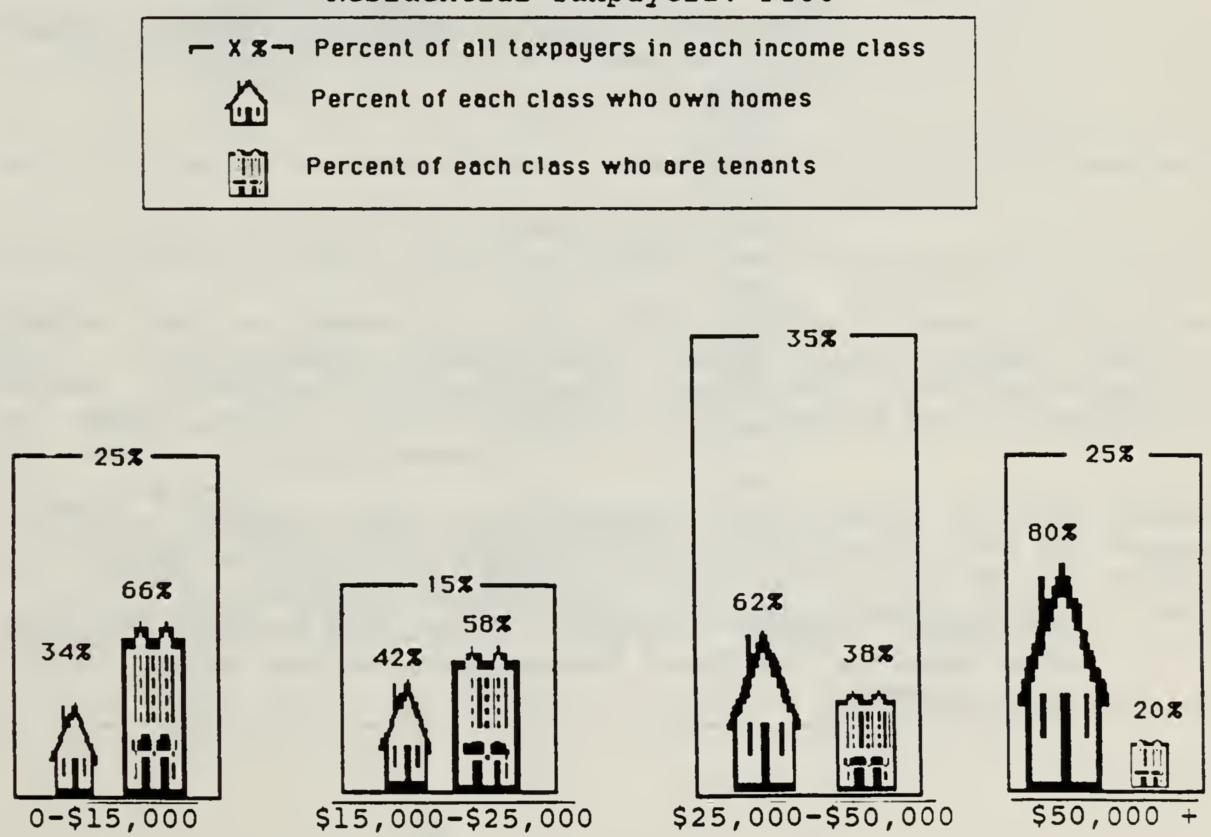
Nearly two-thirds of the total statewide FY87 property tax collections of $3.5 billion came from the taxes paid on residential property.

Residential Property Taxpayers: Income Distribution

Fifty-seven percent of Massachusetts families and individuals are homeowners. Almost 15 percent of these homeowners have incomes below $15,000 and another 13 percent have incomes between $15,000 and $25,000. Of the 43 percent who are tenants, 38 percent have incomes below $15,000 and almost 60 percent have incomes below $25,000.

The graph below illustrates how the residential taxpayers are distributed across income categories and the breakdown of homeowners and tenants within each of the income groups.

Residential Taxpayers: FY86

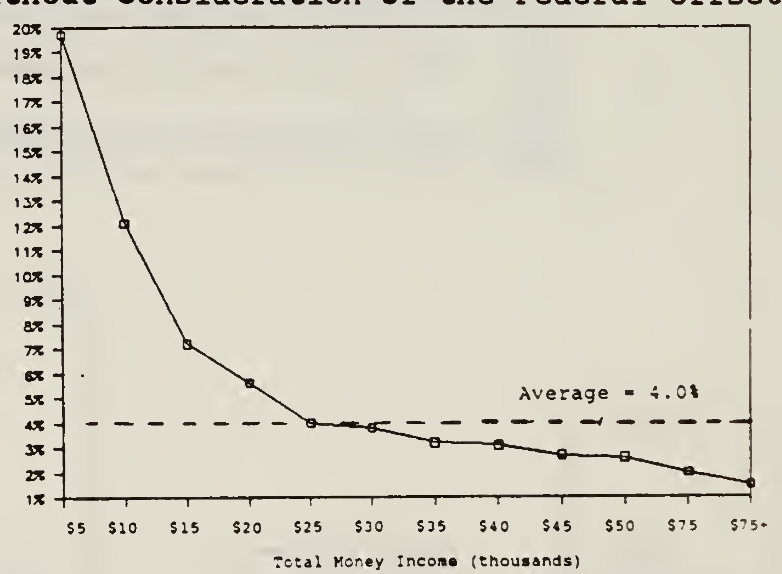


While the property tax burden is limited for all taxpayers by Proposition 2 1/2, the research establishes that the burden falls much more heavily on some, raising questions about its equity -- are some taxpayers paying more than their fair share?

The property tax is, by far, the largest tax liability for low income residents, both homeowners and renters, in the Commonwealth. While the average property tax burden on all residents (homeowners and renters) is 3.6 percent of their total money income, the average burden is 10.1 percent for property taxpayers with below $5,000 in income and seven percent for those with incomes between $5,000 and $10,000. In contrast, the burden for residents with income above $75,000 a year is 1.5 percent.

The graphs and table on the next three pages analyze the property tax burden separately for homeowners and renters. The average annual payment for homeowners is $1,133 ; for tenants, it is $422.

Homeowners: Annual property tax payments as a percent of income
FY84
(Without consideration of the Federal offset*)



*"Federal offset" refers to the tax benefit realized by homeowners who itemize on their federal returns and deduct their local property tax payments.

When the federal offset (the federal income tax deduction for property taxes) is taken into account, the average property tax liability for homeowners, in dollar amounts, is virtually identical for households of all incomes. This means that, when the amount saved on federal taxes is considered, the average homeowner with an income of $10,000 to $15,000, for example, is actually paying virtually the same in property taxes as the homeowner with $50,000 to $75,000 income.

Property Tax Liabilities with Federal Offset
Homeowners FY84

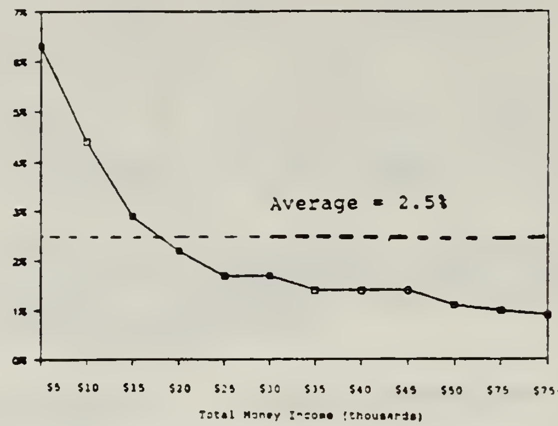
Total Money Income	Property Tax Liability With Federal Offset
Less than $5,000	$ 811
$ 5,000- 9,999	900
$10,000-14,999	878
$15,000-19,999	957
$20,000-24,999	835
$25,000-29,999	935
$30,000-34,999	877
$35,000-39,999	971
$40,000-44,999	908
$45,000-49,999	965
$50,000-74,999	867
$75,000 and over	923
Average	$ 904

Tenants

Tenants pay a share of the property tax through their rent payments. Economists generally assume that renters bear a significant percentage of the property tax burden. The data depicted by the graph on the next page assume that tenants pay 75 percent of the tax.

In FY84, tenants paid, on average, 2.5 percent of their income ($422) in property taxes. This varied substantially from an average of 6.3 percent ($266) for those with incomes below $5,000 to just below one percent ($891) for those in the above $75,000 a year category.

Renters: FY 84 Annual property tax payments as percent of income



The Combined Tax Burden: Property, Sales, and Income

A tax is "regressive" when people with lower incomes pay a greater percentage of their incomes in taxes than do people with higher incomes. Of the three major state taxes (property, sales, and income), the property tax is the most "regressive", i.e. lower income taxpayers pay a greater percentage of their income in taxes than those with higher incomes. As the table below indicates, the property tax is primarily responsible for making the Massachusetts tax system regressive overall.

Tax burdens as a percent of total money income
for the property and the income and sales taxes

Total Money Income	Property Tax	Income Tax	Sales Tax	Sales & Income Tax	Sales, Property & Income Tax
Less than $5,000	10.1	0.0	3.5	3.5	13.6
5,000 - 9,999	7.0	0.0	3.0	3.0	10.0
10,000 - 14,999	5.0	1.3	2.1	3.4	8.4
15,000 - 19,999	4.2	2.5	1.7	4.2	8.4
20,000 - 24,999	2.8	2.8	1.8	4.6	7.4
25,000 - 29,999	2.9	2.8	1.6	4.4	7.3
30,000 - 34,999	2.6	3.3	1.4	4.7	7.3
35,000 - 39,999	2.6	3.4	1.4	4.8	7.4
40,000 - 44,999	2.3	3.8	1.2	5.0	7.3
45,000 - 49,999	2.3	4.0	1.3	5.3	7.6
50,000 - 74,999	2.0	4.1	1.2	5.3	7.3
Greater than 75,000	1.6	4.6	1.0	5.6	7.2

Property Tax Relief

The Commonwealth has adopted several provisions that offer some measure of property tax relief:

--Proposition 2 1/2, which limits overall property taxes and includes a renters' deduction;

--The Classification Amendment, which, at local option, allows some of the tax burden to be shifted onto commercial/industrial properties.

--A local option for an exemption to assist owner-occupants;

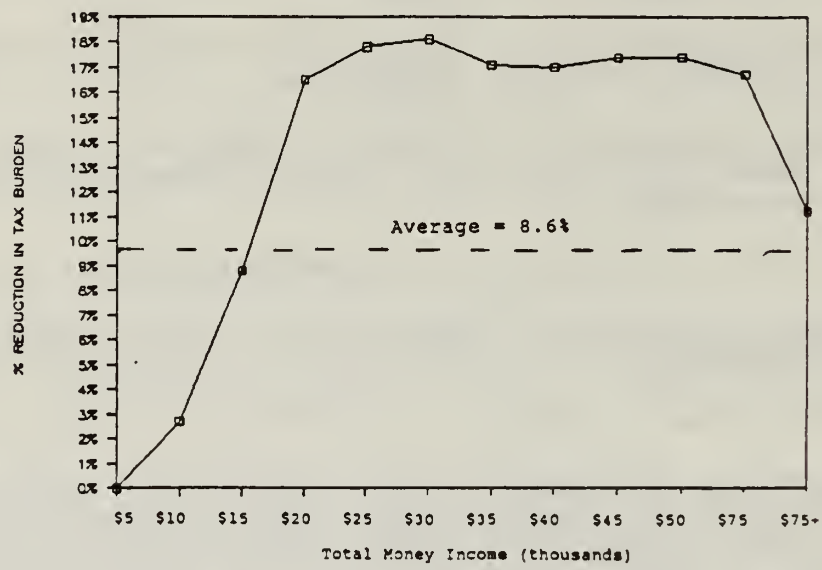
--Various personal exemptions for certain elderly and veteran homeowners.

With the exception of the mandatory property tax restriction of Proposition 2 1/2, these measures are not widely used. While Proposition 2 1/2 has reduced property taxes overall, it does not target the benefits of tax reduction to those in greatest need or spread them evenly among communities.

The one program that provides direct relief for tenants -- the deduction allowed on the personal income tax for rent (up to $2500) -- does not benefit lower income individuals and families because they pay minimal or no income tax due to other provisions of the law.

As illustrated on the next page, the 26 percent of renters who have incomes below $10,000 realize no more than a 2.7 percent reduction in their property tax burden through the rental deduction. The deduction, however, is effective for middle income renters and is also of significant benefit to those at the higher income levels.

Impact of Renters' Deduction (FY84)



Property Taxes and the Elder Taxpayer

One-fourth of homeowners are age 65 or over. On average, their property tax burden is 6.5 percent of their income, almost twice as high as the average burden of 3.1 percent for the non-elder.

The relatively high property tax burden for those 65 and over generally reflects the fact that a higher percentage of older people, as compared to the general population, is poor.

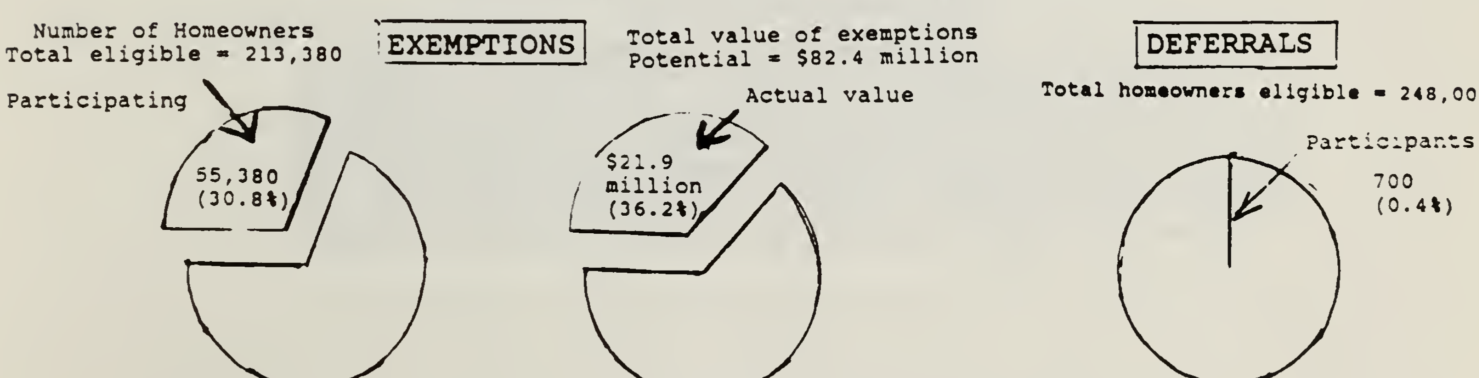
Seven out of 10 homeowners with incomes below $20,000 are elderly. Over one-third of renters who have below $20,000 annual income are 65 or older.

The property tax presents a special problem for elderly residents because so many have low incomes and because they are more likely to own property. Thus, many older homeowners are "property rich and income poor." They own valuable homes but they have insufficient financial liquidity to meet demands such as their property taxes.

There are some property tax relief programs in place for elder homeowners. They provide an exemption for a portion of assessed value --up to a limit-- for homeowners who are 70 or over and meet certain requirements regarding residence and income and/or assets. On average, property tax payments can be reduced by about $130 a year for those who participate.

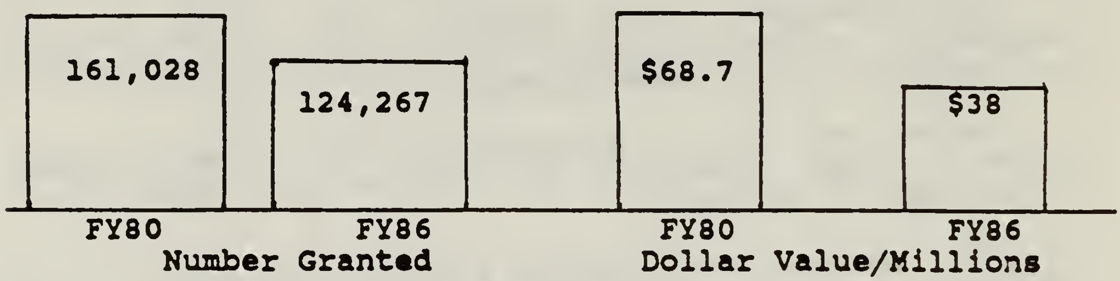
However, as the material below indicates, many eligible people do not participate in the exemption programs or in another program that allows older homeowners to defer property taxes until the property is sold.

Property tax relief programs: Homeowners 70 and over:
1984 Actual and potential participation



Moreover, as the data below show, participation in all of the exemption programs (not just those for the elderly taxpayer) is declining in part due to the fact that asset limits for eligibility, set out by statute, are easily outdated by climbing property values.

Participation in all "Clause" exemption programs*

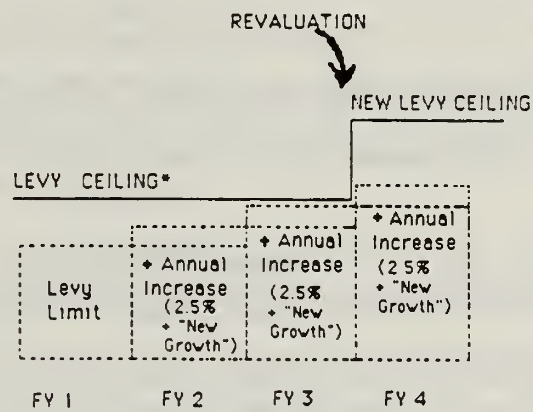


*Including exemptions to disabled veterans, the blind, and paraplegic, as well as those 65 and over.

The Effect of Increased Assessed Valuations

The increases in property values has done a great deal to mitigate the effects of Proposition 2 1/2, particularly in the first few years. Municipalities already under a mandate to bring their property assessments to market value had an added incentive to carry out revaluations -- the higher their valuation, the higher their levy base.

Maintaining market values through the required triennial revaluations gives cities and towns more flexibility to consider increasing their annual levy limit through an override without fear of exceeding the overall rate limit of $25.00 per thousand.



*2.5% of full and fair cash value of taxable property

Shifting the Tax Burden:

The Classification Amendment

Another landmark in the last two decades in municipal finance was the passage of the Classification Amendment that allows communities to shift the burden of property taxation by setting differing tax rates for different classes of property. Within a certain range (and still within the limits of Propotion 2 1/2), Classification allows the tax burden to be shifted from residential property owners to the non-residential sector.

The Residential Exemption

Under another amendment to the law passed in 1982, municipalities are allowed to shift the residential tax burden in a way that gives a tax break to homeowners. Under this "residential exemption," a percentage (up to a certain maximum) of the average assessed value of the residential property in the community may be exempted from taxation for an owner-occupied residence. The effect is to shift the burden onto the owners of second homes, non-owner occupied property (including tenants), and higher-valued homes. The maximum percentage was originally 10 percent; recently the maximum was raised to 20 percent.

BACKGROUND

PROPOSITION 2 1/2
The Limits
Voting to Exceed the Limits
"New Growth"
The Effect of Increased Assessed Valuations

SHIFTING THE TAX BURDEN
The Classification Amendment
he Residential Exemption

PROPOSITION 2 1/2

Proposition 2 1/2, the state's seven-year-old statutory property tax limitation, constrains both the total property tax levy that a city or town can raise and how the much that levy can increase from year to year. ("Levy" is the amount that is collected in property taxes.)

The Limits

There are actually two limits involved. One is an overall cap on the tax rate of 2.5 percent of the total full and fair cash valuation of the taxable real and personal property in a community, representing a rate of $25.00 per thousand dollars of valuation.

The second limit applies to the annual increases to the levy which are set at 2.5 percent of the previous year's levy limit and adjusted to allow the municipality to benefit from the value of certain new construction. The levy limit may grow annually by 2.5 percent plus the growth factor as long as the levy does not exceed 2.5 percent of valuation.

Voting to Exceed the Limits

The law also gives the local voters the right to modify the levy limit in a municipal referenda. They may vote to either permanently or temporarily levy more than would otherwise be allowed by Proposition 2 1/2.

Communities may vote to increase their levy limit by a specified amount to exceed their levy limit to pay off a debt incurred for a specific purpose. A third option is to allow voters to exclude from the levy limit funds to pay for specific capital items in one fiscal year, was created by a 1987 amendment to 2 1/2.

Increasing the Limits with "New Growth"

As the result of an amendment to Proposition 2 1/2, as of FY83 communities were given the option to use the value of specified types of new construction when they establish their annual levy limit.

"New growth" includes new construction or additions that increase the value of residential property at least 50 percent and commercial/-industrial property a minimum of $100,000 or 50 percent. It also includes net increases in the value of subdivision parcels and condominium conversions and the value of any previously exempt property returned to the tax rolls. The added growth is merged in the base used to calculate levy limits for succeeding years so its value is cumulative.

As of FY88, cities and towns were required to adjust their allowable annual levy limits by the amount of tax income that these new properties would produce. (Of course, cities and towns are not required to tax up to this limit.)

Special Commission on Tax Reform: Interim Reports
The Commission will also prepare a final report and recommendations.

General

The Burden and Composition of Massachusetts' Revenue System (H.6352)

Revenue Caps and Rainy Day Funds (H.6545)

Differences in Budgetary Stress Across Massachusetts' Cities and Towns (H.5147)

State Response to Federal Tax Reform in Massachusetts and Other New England States (H.5328)

Personal Taxes

General Background on the Massachusetts Personal Income Tax (H.6443)

Who Pays Massachusetts' Taxes? The Personal Income Tax (H.6386)

Sales Taxation in Massachusetts (H.6500)

Who Pays Massachusetts' Taxes? The Sales Tax (H.5146)

Local Taxes

General Background on Property Taxation in Massachusetts (H.5317)

Who Pays Massachusetts Taxes? The Residential Property Tax (H.5149)

Local Non-Property Taxation: An Option for Massachusetts' Cities and Towns? (H.5233)

Business Taxes

The Massachusetts Corporations Excise Tax: Issues and Options (H.5263)

Should Massachusetts Adopt Unitary Taxation? A Background Study H.5283)

General Background on Taxation of Banks and Thrifts (H.5284)

General Background on Taxation of the Insurance Industry in Massachusetts (H.5785)

Competitiveness of the Massachusetts Revenue System (H.5148)